Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	**WC Docket No. 02-112**
2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules	**CC Docket No. 00-175**

Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

June 30, 2003

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DECLARATION OF LEE L. SELWYN

INTRODUCTION

Qualifications and Assignment

Lee L. Selwyn, of lawful age, declares and says as follows:

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and consulting firm specializing in telecommunications and public utility regulation and public policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof. I have been asked by AT&T to review the *Further Notice of Proposed Rulemaking* ("FNPRM" or

"Notice") issued by the Commission in the above-captioned proceeding, to analyze the issues and questions raised therein, and to provide the Commission with specific recommendations thereon.

2. I have participated in proceedings before the Federal Communications Commission ("FCC" or "Commission") dating back to 1967 and have appeared as an expert witness in hundreds of state proceedings before more than forty state public utility commissions. I have participated in numerous regulatory proceedings involving public utility affiliate relationships and inter-affiliate transactions and transfers. These have included merger proceedings before the California PUC involving Pacific Telesis Group and SBC, and Bell Atlantic and GTE, before the Illinois Commerce Commission involving SBC and Ameritech, before the Connecticut Department of Public Utility Control involving SBC and SNET, and before the Maine PUC involving NYNEX and Bell Atlantic. I also participated in written comments filed with the FCC regarding both the SBC/Ameritech and Bell Atlantic/GTE merger applications. I have participated in a number of Section 271 proceedings, including those in Pennsylvania, New Jersey, California, Minnesota, Delaware and Virginia. I have also submitted testimony before several state commissions addressing proposals for structural separation of ILEC wholesale and retail operations. I participated in proceedings before the California PUC involving Pacific Bell's reorganization of its Information Services (primarily voice mail) business into a separate subsidiary, and the spin-off of Pacific Telesis Group's wireless services business into a separate company. I have participated in a number of matters involving the treatment of transfers of yellow pages publishing from the ILEC to a separate directory publishing affiliate, including the

recent case before the Washington Utilities and Transportation Commission addressing imputation of (then) US WEST yellow pages revenues.

Summary

3. The BOCs' market power in the local market allows them to set prices at supracompetitive levels both for retail end user services as well as for the wholesale essential bottleneck services that constitute critical inputs to the local and long distance services being provided by CLECs and IXCs. Although BOCs and other ILECs have been required to open their markets to local competition since the passage of the *Telecommunications Act of 1996* some seven-and-one-half years ago, CLEC entry has been extremely limited, and in any event has failed to provide competitive pressures sufficient to constrain incumbent carrier prices and conduct. Nationally, CLECs have achieved only a 13% local retail market share, and the inflation adjusted price of local telephone service continues to rise. According to the latest FCC *Local Competition Report*, ILECs still control at least 96.6% of all local exchange service facilities either as their own retail services or as the underlying wholesale services furnished to CLECs.

4. The "carrot" of long distance reentry by the BOCs, intended by Congress to spur them into opening their network, was not successful in incenting the BOCs to comply fully with the unbundling, interconnection and pricing requirements of Sections 251 and 252. As a result, local competition remains minimal, and BOC dominance of the local market remains both undiminished and essentially unchallenged. Although the principle underlying the Section 271 long

elimination of stand-alone long distance service providers will necessarily result in BOC remonopolization of the long distance market as well.

6. The Commission's previous reliance in the *LEC Classification Order* upon the separate affiliate requirements of Section 272 to forestall BOC anticompetitive conduct during the first three years following long distance entry in a given state has now been shown to have been seriously misplaced. There is significant evidence from the Section 272 Audits and from BOC revealed conduct that, as implemented, these requirements have failed to protect competitors from BOC anticompetitive acts. If classified as dominant carriers, BOCs will be compelled to file detailed cost support and other data and documentation in connection with their tariffs and prices, and to affirmatively demonstrate that any proposed rates or rate changes are compliant with all applicable imputation, cost allocation, cost recovery, and nondiscrimination requirements. The BOCs' incentives to misallocate costs of functions that jointly support both their local and long distance operations, and in so doing to benefit their competitive services at the expense of monopoly customers, are substantial, and there is substantial evidence that the BOCs have persistently engaged in such conduct, even with the separate affiliate requirements of Section 272 in place. Treatment of the BOCs as dominant carriers will permit the Commission to monitor and thus to assure BOC compliance and, so long as the BOCs are in compliance, will not subject them to consequential costs or burdens.

7. The BOCs' dominance of the local market assures their continuing dominance of the wholesale access services market as well. Prior to their reentry into the long distance market,

BOCs did not compete with purchasers of their monopoly access services (i.e., with IXCs), but they now do. The continuing practice of pricing carrier access services at multiples of incremental cost — which is particularly prevalent at the state level — affords the BOCs an enormous competitive advantage by allowing them to simultaneously raise their rivals' costs while enabling them to price their own retail long distance services below the level of access charges, imposing a price squeeze upon competing IXCs. At a minimum, dominant carrier regulation must be maintained at least for so long as access charges remain at these excessive levels.

8. BOCs have made extraordinary and unprecedented market gains following their receipt of Section 271 in-region long distance authority, and SBC, for one, has predicted an end-state retail market share of 60% based upon its actual experience in Connecticut, where long distance entry was never conditioned upon the requirement that SBC (or its predecessor, SNET) satisfy the Section 271(c)(2)(B) "competitive checklist." That outcome, if extended nationally, create a strong likelihood that the BOCs will possess sufficient market power to be able "profitability to maintain prices above competitive levels for a significant period of time." Without the safe-guards that can be maintained only through dominant carrier treatment, BOCs will have both the incentive and the ability to engage in predation, and to permanently increase their prices once their rivals are forced out of the market.

THE BOCS HAVE BOTTLENECK MARKET POWER

The BOCs' tremendous market power in the local market allows them to raise both retail end user prices as well as the wholesale prices of the essential bottleneck services relied upon by CLECs to compete.

9. The FCC has defined market power as, *inter alia*, "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."[1] In a competitive, multi-firm market, consumers are able to shift their purchases easily among the various suppliers in response to any unilateral action by any individual firm to raise its price above the competitive market level. Under these conditions, consumers can be expected to respond to a price increase initiated by any one firm by rapidly shifting their business to another provider whose prices have remained stable. As a result, the attempt by the first firm "to raise and maintain price above the competitive level" will not be successful, and could not be sustained.

10. While BOCs have repeatedly claimed that they confront competition in the local market — and have sought to support those contentions with "head counts" of purported "competitors" — at bottom there has never been any demonstration that BOCs are *not* able "to raise and

1. *Competitive Carrier Fourth Report and Order,* 95 FCC 2d at 558, at para. 8 (citing *inter alia* W.M. Landes & R.A. Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 937 (1981), and A. Kahn, *The Economics of Regulation* 65-66 (1970)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as "the ability profitability to maintain prices above competitive levels for a significant period of time." 1992 Merger Guidelines, at 20,570.

maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." To the contrary, while feigning competitive pressures, BOCs have frequently *raised their prices* when given the "pricing flexibility" to do so.[2] Hence, there is no basis for the Commission to find that there has been *any* consequential diminution of BOC market power in the local services market since the date of enactment of the 1996 law.

11. The BOCs' ability to raise prices — particularly for "mass market" services — without driving away customers is a direct result of their overwhelming dominance of the local exchange market. The FCC's just-issued *Local Competition Report* for end-of-year 2002 puts the ILEC share of access lines, including resale and UNE services provided to CLECs, at 96.6%.[3] According to the FCC *Local Competition Report*, some three-quarters of all CLEC lines utilize underlying services and facilities obtained from ILECs and, although not specifically addressed by the FCC study, that percentage is undoubtedly even higher for CLEC mass market residential and small business customers.[4] In fact, the ILEC facilities-based share is actually *greater* than

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2. *See, AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Service*, RM 10593, *Petition*, filed October 15, 2002.

3. FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of December 31, 2002*, Rel. June 12, 2003, ("*Local Competition Report*") at Tables 3&4. Calculation was made using the ILEC total lines from Table 4 (which includes ILEC end user lines, resold lines and UNEs) divided by the sum of ILEC total lines and CLEC-owned lines (from Table 3).

4. As I noted in my January 23, 2003 Declaration in RM 10593, *In the Matter of AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier*

(continued...)

the sum of resale-plus UNE-based CLEC services cited above, because CLECs also make extensive use of ILEC-provided special access services to serve their small- and mid-sized business customer premises.

12. The same *Local Competition Report* notes that at the close of 2002 CLECs nationally had only a 13% local market share, and some 31% of US zip codes lacked even a single competitive local provider.[5] Despite BOC claims that their entry into the interLATA market is the catalyst that will stimulate CLEC entry, the "facts on the ground" do not come even remotely close to supporting that contention. For one thing, even for those states in which CLEC retail penetration is highest, the penetration of *facilities-based* competitive services is minimal. According to FCC data, for the forty-two states (and the District of Columbia) in which in-region long distance entry has been permitted (plus Connecticut and Hawaii, where no such authority was required), BOCs (and, in the case of Connecticut and Hawaii, non-BOC ILECs) provide the underlying facilities for roughly 86.6% of all residential lines (see Table 1).

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4. (...continued)
Rates for Interstate Special Access Services, at para. 18, AT&T currently provides service at approximately 186,000 commercial buildings. Of these, AT&T *owns* facilities to only about 6,700 buildings, and obtains facilities *from other CLECs* at approximately 3,300 additional locations. Thus, competitive alternatives to ILEC special access service are available at only about 10,000 locations, representing roughly 5.7% of the approximately 186,000 commercial buildings at which AT&T currently provides service, and at less than 0.4% of the 3- to 4-million commercial buildings nationwide.

5. FCC *Local Competition Report*, December 2002), at Tables 6 and 14.

Table 1

CLEC-Reported End-User Switched Access Lines by State
(As of December 31, 2002)

State	Total CLEC Lines	Total CLEC Lines Served Over ILEC Facilities	End-User ILEC Access Lines	Total Access Lines	ILEC Lines as a Percent of Total Lines
Alabama	187,320	166,144	2,238,352	2,425,672	92.28%
Arkansas	144,411	95,431	1,257,291	1,401,702	89.70%
California	2,698,705	1,807,673	21,475,881	24,174,586	88.84%
Colorado	482,014	275,450	2,642,166	3,124,180	84.57%
Connecticut	236,462	131,417	2,263,446	2,499,908	90.54%
Delaware	*	*	525,447	*	*
District of Columbia	160,174	93,673	831,920	992,094	83.85%
Florida	1,495,132	1,165,488	10,406,129	11,901,261	87.44%
Georgia	780,970	611,428	4,423,324	5,204,294	84.99%
Hawaii	*	*	723,111	*	*
Idaho	*	*	700,089	*	*
Iowa	201,176	164,007	1,329,633	1,530,809	86.86%
Kansas	258,312	211,992	1,236,051	1,494,363	82.71%
Kentucky	92,483	42,819	2,100,313	2,192,796	95.78%
Louisiana	188,652	151,096	2,353,620	2,542,272	92.58%
Maine	*	*	750,749	*	*
Maryland	285,416	261,641	3,502,515	3,787,931	92.47%
Massachusetts	750,473	384,471	3,750,998	4,501,471	83.33%
Minnesota	572,708	420,086	2,708,221	3,280,929	82.54%
Missouri	336,895	266,760	3,145,872	3,482,767	90.33%
Montana	*	*	509,979	*	*
Nebraska	177,698	62,602	828,394	1,006,092	82.34%
Nevada	163,520	128,428	1,348,042	1,511,562	89.18%
New Hampshire	125,893	66,485	723,653	849,546	85.18%
New Jersey	682,249	603,693	5,883,106	6,565,355	89.61%
New Mexico	*	*	965,816	*	*
New York	3,190,192	2,748,731	9,646,157	12,836,349	75.15%
North Carolina	405,853	329,164	4,824,385	5,230,238	92.24%
North Dakota	*	*	293,639	0	0.00%
Oklahoma	207,798	93,454	1,726,359	1,934,157	89.26%
Oregon	183,319	138,007	1,955,544	2,138,863	91.43%
Pennsylvania	1,405,894	867,493	7,167,204	8,573,098	83.60%
Rhode Island	145,202	55,043	526,143	671,345	78.37%
South Carolina	161,121	151,484	2,210,548	2,371,669	93.21%
Tennessee	326,663	226,283	3,147,556	3,474,219	90.60%
Texas	2,182,929	1,756,761	10,766,127	12,949,056	83.14%
Utah	194,352	103,089	1,075,061	1,269,413	84.69%
Vermont	*	*	383,758	*	*
Virginia	639,330	364,102	4,262,823	4,902,153	86.96%
Washington	406,750	228,457	3,553,994	3,960,744	89.73%
West Virginia	*	*	950,564	*	*
Wyoming	*	*	251,672	*	*
Total	19,470,066	14,172,852	131,365,652	150,835,718	87.09%

Note: States marked with an * had CLEC line figures too low to maintain firm confidentiality. These numbers are assumed to be zero.
Source: *FCC Local Competition Report*, Tables 9-10.

13. New York, the most frequently cited example of "robust" local competition, is still struggling with BOC local market power, and CLEC growth has slowed to a snail's pace despite favorable UNE rates.[6] A report including an analysis of local competition presented recently by the staff of the New York Public Service Commission (NYPSC) indicates that CLEC penetration rates in New York actually *decreased* in the second quarter of 2001, suggesting that the initial CLEC gains following Verizon's interLATA entry could not be sustained.[7] The NYPSC staff attributes this drop to poor performance in the CLEC capital market, to UNE pricing problems, and to a myriad of small obstacles placed by Verizon upon CLEC competitors attempting to interconnect with or secure facilities from the BOC.[8] The FCC's most recent *Local Competition Report* confirms the NYPSC staff's conclusion, noting that the New York CLEC market share has remained at 25% for the last year and a half.[9]

14. Access line facilities are not fungible from one location to another: The fact that a CLEC might own facilities serving some specific buildings in a particular zip code does not

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6. *Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework*, NYPSC Case 00-C-1945, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, NYPSC Case 98-C-1357, *Order Instituting Verizon Incentive Plan*, New York Public Service Commission, February 27, 2002.

7. New York Public Service Commission, *In the Matter of Verizon–New York*, Case No. 00– C– 1945, Report of Commission Staff, February 2002, at 18-19.

8. *Id.*

9. *Local Competition Report*, at Table 7.

make such CLEC-owned facilities available ubiquitously throughout that — or any other — zip code. ILECs clearly possess "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable" precisely because the *supply elasticity* confronting CLECs is extremely low. CLECs cannot rapidly respond (or in most cases cannot respond at all) to an ILEC price increase by expanding their own facilities, which is the only condition (short of regulation) that would be capable of constraining an ILEC price increase. BOCs must continue to be classified as *dominant* carriers with respect to *any service* that is linked to the access line platform, *including and especially any long distance services that are bundled with basic exchange service under a single pricing package.*

15. The BOCs seek to attribute the persistently low CLEC supply elasticity to what the BOCs claim to be UNE rates that do not cover their costs. SBC, for example, contends that were UNE rates to be increased, CLECs would then invest in their own facilities.[10] However, evidence recently offered *by SBC* to the United States District Court for the Northern District of Illinois, Eastern Division,[11] directly belies this contention.

10. *See, e.g. Voices for Choices et al v. Illinois Bell et al*, Before the US District Court for the Northern District of Illinois Eastern Division, No. 03 C 3290, ("*Voices for Choices et al v. Illinois Bell et al*") Affidavit of Debra J. Aron on Behalf of SBC Illinois, filed May 27, 2003 ("*Aron affidavit*").

11. *Voices for Choices et al v. Illinois Bell et al*, Affidavit of Randall S. White on Behalf of SBC Illinois, filed May 27, 2003 ("*White affidavit*").

16. In the Illinois case, SBC affiant Randall C. White confirms that CLECs' apparent failure to deploy facilities of their own is not *caused* by what SBC seeks to portray as "subsidized" UNE prices, but rather is due to the *enormous cost* that a CLEC would be forced to incur to deploy its own distribution network, when expressed on a per-customer basis. Mr. White explains that "[o]utside plant represents the largest capital and expense category in SBC Illinois' operating budget."[12] Were a CLEC to engage in its own outside plant facilities construction, that same condition would surely apply to the CLEC as well. Mr. White explains that

> ... distribution plant is sized to meet the long-term ultimate demand of residence and business customers within a specific geographic area. Unlike feeder cables, distribution cables are not as readily accessible. ... Therefore, distribution facilities in urban/suburban areas are sized to meet the expected long-term ('ultimate') demand for telecommunications facilities in that neighborhood.[13]

While this "meet ultimate demand" engineering requirement means that SBC will typically deploy more loops along a given street or in a given subdivision than there are (current) lines in service, an ILEC can nonetheless generally count on providing *at least one line,* either at retail or as a UNE, to virtually 100% of the existing and future households along the distribution cable route. That is not the case with an individual CLEC. For example, SBC Illinois currently serves

12. *Id.*, at para. 14.

13. *Id.*, at para. 19.

some 5.97-million network access lines in the state.[14] According to SBC, there are currently 54 CLECs providing service in Illinois, of which only seven currently serve in excess of 35,000 access lines.[15] The largest CLEC in Illinois serves only about 6% of that 5.97-million, largely via UNE-Loops or UNE-P.[16] Of the remaining 47 small CLECs, the largest of these serves no more than 35,000 lines, or no more than 0.6% of the SBC Illinois total. Mr. White states that "[s]izing distribution facilities ... to accommodate long-term [ultimate] demand is a standard practice in the telecommunications industry."[17] Thus, any CLEC undertaking to construct its own distribution facilities would necessarily have to size its cables on the same basis — i.e., to satisfy ultimate demand in the area being served.[18] So if a particular neighborhood requires

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14. ARMIS, Report 43-08, Table 2, *Switched Access Lines in Service, Year-end 2002,* "Total Switched Access Lines" column.

15. *Aron affidavit*, at para. 71.

16. *Id.*

17. *White affidavit*, at para. 22.

18. One might argue that for a CLEC the correct engineering standard is "ultimate *expected* demand" rather than "ultimate [total] demand." Even in that case, however, the CLEC's cost would not be proportionately lower. As SBC's Mr. White expressly notes, "[t]he most costly element in installing outside plant facilities is the labor, not the plant itself, and labor costs increase over time. For example, for any given job, installation labor costs represent more than 70% of the total cost." *White affidavit*, at para. 39. Since installation labor is not materially impacted by the physical size (capacity) of the cable being installed, a CLEC constructing distribution facilities based upon *its* ultimate expected demand (assuming, say, an ultimate 20% market share) would *at the very most* save 80% of the 30% of *non-labor* costs, i.e., that job would still cost about 76% of what the BOC would spend. However, many of those costs — such as supporting structures, rights-of-way, and construction equipment — are also fixed relative to cable size. Hence, even if the CLEC were to build capacity only to serve its own

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deployment of 1,000 loops to satisfy ultimate demand, a facilities-based CLEC would need to undertake that same 1,000-loop build that would apply for SBC Illinois. SBC's average distribution fill in Illinois is 41%.[19] So, on average, for a 1,000-pair distribution loop facility that SBC Illinois constructs, it can expect to put about 410 pairs into revenue-producing service.

17. Now consider the conditions that a facilities-based CLEC would confront in order to serve the same neighborhood. It would need to build a similarly-sized facility (i.e., 1,000 loops) to meet ultimate demand; even if it were to deploy a smaller capacity distribution cable, its costs would not be substantially lower. However, unlike SBC Illinois, it could not count on serving on average the 410 revenue-producing lines. The largest CLEC, with a roughly 6% share, could only count on serving, on average, about 25 lines out of the 1,000-pair facility; a small CLEC, with a 0.6% share, could only expect to serve, on average, about 2.5 lines out of the 1,000 pairs that it would need to deploy. Assuming that the CLECs' construction costs are in all other respects comparable to those of SBC Illinois,[20] the largest (6% share) CLEC would incur a

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18. (...continued)
ultimate expected demand, its total costs would not be materially different from the BOCs' *but its per-loop cost would be many multiples thereof.*

19. *Aron affidavit*, at para. 29.

20. The costs of facilities construction confronted by any individual CLEC are likely to be considerably higher for an otherwise comparable project than those that SBC Illinois would incur, due to the CLEC's considerably smaller size and purchasing power. In addition, because any individual CLEC will necessarily confront far greater competitive risk than the market dominating SBC Illinois, its risk-adjusted cost of capital will be a good deal higher, assuming of course that the capital is available to the CLEC in the first place.

capital construction cost per *revenue-producing* loop that is some *16 times* what SBC would confront for each revenue-producing loop that it deploys. A small (0.6% share) CLEC would confront per-working-loop costs that are some 164 times that which SBC pays. And CLECs that are even smaller than the 35,000-line level would confront even higher multiples of SBC's costs were they to undertake facilities construction of their own. Thus, the BOCs' local market power is currently, and shall remain for the foreseeable future, intact. CLECs are not investing in their own subscriber loops because the cost of doing so is prohibitively expensive, not because the TELRIC-based price that the BOCs are required to charge for UNEs is "too low" or is being "subsidized" as the BOCs pejoratively claim. Indeed, SBC's evidence provides compelling support of the inescapable *fact* that with limited exceptions involving high concentrations of CLEC customers in densely-populated central business districts of major cities, subscriber loops are a "natural monopoly" by any traditional standard.

18. Resale CLECs have even less ability to compete with the BOC, even *and especially* when the BOC raises its retail prices. Pricing of "resale" services is, of course, directly linked with the BOC's *retail* price (which, pursuant to 47 U.S.C. 252(d)(3), are set "on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier"). If an ILEC raises its retail prices, it concurrently and correspondingly raises its wholesale resale prices as well, forcing resellers to make lock-step adjustments in their own retail rates. Although UNE rates are not set specifically in relation to the BOCs' retail prices, UNE rates and UNE availability, of course, continue to be the subject of

considerable controversy, and the sustained economic viability of *any* CLEC business plan premised upon the ongoing availability of ILEC facilities is anything but certain. The BOCs' ability, as an economic matter, to set UNE and resale prices at supracompetitive levels arises directly from the utter lack of competitive supply of the underlying local service facilities. As the Commission's *Local Competition Report* confirms, the vast majority of CLEC services are furnished by means of resold ILEC services and UNEs, and the figure would be even high if special access facilities acquired from ILECs are included. CLECs do not even have the physical capacity to serve more than a small fraction of their existing retail demand, and they certainly would have no ability to rapidly expand their facilities in response to increased BOC prices. This near-zero CLEC supply elasticity affords the BOCs the ability to control and limit output in the downstream market by raising the costs of downstream competitors' inputs, which also forces retail prices being charged by downstream firms to be higher than they would otherwise be. This, in turn, provides the BOCs with a price umbrella for their own retail services, resulting in higher BOC rates and reduced BOC output as well. Thus, while there might (perhaps) be sufficient competitive alternatives for the (at most) 3.4% of access lines that are being served via CLEC-owned facilities, *for the 96.6% or more of the lines that are furnished by means of ILEC-owned facilities* the only way in which the ILEC will experience a net loss of business as a result of a price increase is in the exceedingly rare situation in which the customer elects to do without local telephone service altogether.

19. The BOCs' local market power has not diminished since 1997. When considering the bundling of services in March 2001, the Commission again found that BOCs retain market

power in the local exchange market, and based its policy upon the conclusion that Section 272 provided a check on the ability of a BOC to leverage its local market power into adjacent markets:

> Despite the inroads made by competitors into the local exchange market that we described above, incumbent LECs retain market power in the provision of local service within their respective territories. Thus, unlike our previous analysis of the interexchange market or nondominant LECs, incumbent LECs possess one of the essential characteristics for engaging in anticompetitive behavior — market power with respect to one of the components in the bundle. Nonetheless, we conclude, in light of the existing circumstances in these markets, that the risk of anticompetitive behavior by the incumbent LECs in bundling CPE and local exchange service is low and is outweighed by the consumer benefits of allowing such bundling. We view the risk as low not only because of the economic difficulty that even dominant carriers face in attempting to link forcibly the purchase of one component to another, *but also because of the safeguards that currently exist to protect against this behavior.*[21]

20. As recently as July 15 of last year, FCC Chairman Michael Powell was quoted in *The Wall Street Journal* reiterating the conclusion that BOCs have been slow to lose their market power in the local market: "We correctly believed these markets didn't need to be natural

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21. *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended*; CC Docket No. 96-61; *1998 Biennial Regulatory Review — Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets*, CC Docket No. 98-183, *Report and Order*, Rel. March 30, 2001, 16 FCC Rcd 7418, 7438, emphasis supplied. At 16 FCC Rcd 7434, the Commission specifically notes Section 272, *inter alia*, as providing sufficient protection against the market power of the BOCs.

monopolies and they could be competitive, but I think we tended to over-exaggerate how quickly and how dramatically it could become competitive."[22]

21. The FCC is not alone in remaining concerned about BOC local market power and its potential anticompetitive effects. The New York PSC found that Verizon New York remains dominant in the special services (i.e., UNEs and special access) market:

> Verizon's data, as well as the advantages attendant upon its historical incumbent position, indicate it continues to occupy the dominant position in the Special Services market, and by its dominance is a controlling factor in the market. Because competitors rely on Verizon's facilities, particularly its local loops, Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services. In this situation, regulation is needed to assure the development of competitive choices, and good service quality when choices are not available. Accordingly, we find that a competitive facilities-based market for Special Services has yet to emerge and that Verizon continues to dominate the market overall.[23]

CLECs and IXCs depend heavily upon BOC special services in order to furnish retail local and long distance services to their own customers. By virtue of their control over these bottleneck

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22. "FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom," *The Wall Street Journal*, July 15, 2002, at A1, A4.

23. *Proceeding on Motion of the Commission to Investigate Methods to Improve and Maintain High Quality Special Services Performance by Verizon New York Inc.*, Case 00-C-2051, *Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company*, Case 92-C-0665, before the New York Public Service Commission, *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, June 15, 2001, at 9.

facilities, BOCs are in a position to restrict the availability of these essential services to their rivals. If the special services market were competitive, the creation of artificial limitations on service availability would not be possible. The Indiana Utility Regulatory Commission recently concluded:

> However, we cannot ignore the potential negative consequences or anti-competitive effects that could flow from an unrestricted grant of authority to an affiliate of the largest ILEC in Indiana. The conditions that are ordinarily imposed on facilities-based carriers are only a starting point as those conditions were designed primarily for CLECs. This docket involves certification of an affiliate of the largest ILEC in the state. This Cause also involves an affiliate intending to use advanced technology and investment in the public network for the provision of advanced services. Ameritech Indiana as the dominant local exchange provider has the incentive and capability to exercise market power.[24]

The Montana PUC echoed Indiana's concern:

> The Commission is sympathetic to the concerns expressed by the parties and recognizes that the competitive local exchange market will likely create opportunities for customers to obtain services from alternate providers even though they may have delinquent accounts with a competitor. This will be a change for the incumbent LEC which has been the only provider of telecom-

24. *In the Matter of the Petition of Ameritech Advanced Data Services of Indiana, Inc. (Which Is In the Process of Adopting the Business Name of SBC Advanced Solutions, Inc.) For A Certificate of Territorial Authority to Provide Facilities-based and Resold Telecommunications Services Throughout the State of Indiana and Requesting the Commission to Decline to Exercise Jurisdiction Pursuant to I.C. 8-1-2.6*, Indiana Utility Regulatory Commission Cause No. 41660, *Opinion*, 2001 Ind. PUC LEXIS 275, approved May 19, 2001, at *39-*40.

munications service in the past and which still has near total market power, particularly in rural states like Montana.[25]

22. Raw data purporting to quantify the extent of CLEC market penetration that has been offered by BOCs in various Section 271 proceedings is, at a minimum, highly controversial[26] and does not establish that competition exists "on the ground" at a level that offers consumers a realistic alternative to the BOC's services or that works to limit or constrain the BOC's market power.

25. *In the Matter of the Application of Citizens Telecommunications Company of Montana and CommSouth Companies, Inc., Pursuant to Section 252(e) of the Telecommunications Act of 1996 for Approval of Their Resale Agreement*, Montana Public Service Commission, Utility Division Docket No. D2000.7.104; Order No. 6281, *Final Order*, Montana Public Service Commission, 2000 Mont. PUC LEXIS 121, October 16, 2000, at 13.

26. In seeking to quantify the extent of CLEC market presence, BOCs have relied upon CLEC E911 database entries adjusted to exclude UNE-Loops, as indicative of the number of CLEC facilities-based lines. But E911 database records are keyed to *telephone numbers*, not telephone *lines*, and in the case of multiline business customers the quantity of individual telephone numbers may be a multiple of the number of individual lines. In addition, BOCs have typically not excluded from the E911 "number counts" non-UNE BOC facilities that are being leased to CLECs such as and including Special Access lines. In fact, since CLECs are frequently unable to utilize UNE-loops to serve multiline business customers, the quantity of BOC Special Access facilities being leased by CLECs likely represents a substantial fraction — possibly even the *majority* — of CLEC-provided retail lines.

Attainment by a BOC of Section 271 in-region interLATA authority cannot be construed as demonstrating or implying that the BOC no longer has market power or that the local market in the state in which such authority has been granted has become competitive.

23. Section 271(c)) of the 1996 *Act* sets forth the specific requirements that a BOC must satisfy in order to obtain authority to provide in-region interLATA services. The BOC must, if applying under "Track A," demonstrate only that it has entered into at least one (1) interconnection agreement with a competing local service provider providing service (other than by resale of the ILEC's services) to residential customers and to business customers. The BOC must also satisfy a "checklist" of fourteen "specific interconnection requirements" that, for the most part, are reiterations of obligations that are imposed by Section 251 upon *all ILECs* separate and apart from any long distance entry *quid pro quo*.

24. At no point in the Section 271 process does the FCC apply its market power test. As interpreted by the FCC, Section 271 does not require a BOC to demonstrate that actual entry has occurred, that competing services are available generally throughout the state in question, or that the incumbent BOC has suffered or sustained any diminution of its preexisting market power.[27] In fact, the FCC has on several occasions *rejected* arguments, advanced by competing IXCs and

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27. If the BOC is applying for Section 271 authority under "Track A" (i.e., Section 271(c)(1)(A)), it is only required to demonstrate that there is a minimum of just "one competing carrier" offering service to residential and to business customers in the state utilizing either the CLEC's own facilities or UNEs leased from the BOC. *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1934, as amended, To Provide In-Region, InterLATA services In Michigan,* CC Docket No. 97-137, *Memorandum Opinion and Order*, Rel. August 19, 1997, 12 FCC Rcd 20543, 20598.

others, that a BOCs' continued dominance and pervasive control of the local market would make approval of its in-region interLATA entry contrary to the public interest notwithstanding its apparent satisfaction of the "competitive checklist."[28]

25. Inasmuch as the threshold conditions for the FCC's grant of in-region interLATA authority do not require the BOC to demonstrate, or the FCC to find, that *effective competition* has developed or that the BOC no longer has market power in the local market in a given state, the fact that a BOC has obtained Section 271 in-region interLATA authority cannot be construed as implying that it no longer has market power or that the local market in the state in which such authority has been granted — and particularly in all parts of that state — has become competitive. Indeed, in establishing the Section 272(a) and (b) separate affiliate requirements and the Section 272(c)) and 272(e) nondiscrimination requirements, Congress clearly sought to dissociate a BOC's satisfaction of Section 271(c)) with any finding or determination that it no longer had market power. On the other hand, Congress also understood that *if* the development of actual and effective competition in the local market were to occur, then the BOCs' market power could be diminished or perhaps even eliminated. But Congress had no illusions about that taking place immediately upon enactment of the 1996 law, immediately upon a BOC's receipt of Section 271 authority in a given state or, for that matter, even after a finite and predetermined interval of time following such grant. As the FCC has allowed Section 272 to sunset, non-

28. *See*, e.g., *In the Matter of the Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, *Memorandum Opinion and Order*, 15 FCC Rcd 3953, 4163 ("*Bell Atlantic New York Order*").

dominant interLATA treatment at a time when the BOC still maintains extensive market dominance and market power would be inconsistent with, and would therefore frustrate, the specific policy goals underlying the *Act*.

Experience in Connecticut and Hawaii belies any claims by BOCs that IXCs commence offering local service in a state as CLECs only after a BOC's receipt of Section 271 authority threatens their long distance market share.

26. The cases of Connecticut and Hawaii provide compelling examples that confirm the conclusion that BOC long distance entry cannot assure that the local service market will become competitive. At the time of the break-up of the former Bell System, two of the "Bell System" companies — The Southern New England Telephone Company ("SNET") in Connecticut and Cincinnati Bell, Inc. in Ohio and Kentucky — were only minority-owned by AT&T and were not required to be divested or made subject to the interLATA long distance line-of-business restriction that applied to all of the other Bell Operating Companies. AT&T voluntarily divested its remaining interest in both of these companies shortly after the break-up, and both were free to enter the long distance market at any time from 1984 onward. The GTE operating companies were not subject to the Bell MFJ line-of-business restriction, but became subject to a similar prohibition against long distance entry when GTE acquired a controlling interest in Sprint. However, the 1996 *Telecommunications Act* lifted the GTE long distance ban,[29] and the GTE companies were free to — and did — enter the long distance market as of the date of enactment,

29. 47 U.S.C. § 601(a)(2).

i.e., February 8, 1996. SNET, in fact, entered the Connecticut long distance market in 1993,[30] some *seven years sooner* than Verizon and SBC began offering such services in New York and Texas, respectively. Following enactment of the 1996 law and adoption of implementation rules by the FCC later that year, SNET and the GTE companies, all of which are ILECs as defined at 47 U.S.C. §251(h), were required to comply with the unbundling, resale, interconnection, and nondiscriminatory access to poles, ducts, conduit, operator services, directory assistance, directory listings as well as other the requirements of Sections 251 and 252 that I have previously enumerated. These obligations are very similar to the market opening requirements of Section 271(c)(2)(B), and when complied with by the ILECs *as they are required to do* would afford competitors the same ability to enter the local market in the *non-BOC* ILEC service areas as would prevail in BOC jurisdictions once the "competitive checklist" had been satisfied.

27. SNET is the dominant ILEC in Connecticut, and GTE (now Verizon) is the *sole* ILEC in Hawaii. If in fact there were any kind of *causal link* between ILEC long distance entry and the "stimulation" of local competition, one would expect to see rampant CLEC activity and market penetration in both of these states, as well as in such concentrated GTE (now Verizon) local service areas as southern California and the west coast of Florida. The facts speak otherwise. Studies by the FCC and others confirm that despite these ILECs' *early* long distance entry,

30. SBC Investor Briefing, *SBC Enters $7.7 Billion Texas Long-Distance Market*, July 10, 2000.

very little competitive *local* entry has occurred. The CLEC share in Connecticut is only about 9%, and CLEC activity is virtually nonexistent in Hawaii.[31]

28. Finally, the extraordinary difficulties that CLECs confront when attempting to compete with a BOC or other ILEC is compellingly demonstrated by the fact that the two largest BOCs — Verizon and SBC — have themselves failed to actively pursue out-of-region *local* market entry (as CLECs) *even after having specifically represented to the FCC that they would do so.* SBC, in its Joint Application for approval of its merger with Ameritech,[32] and Verizon, in its Joint Application for approval of its merger with GTE,[33] each represented that following their respective mergers the two mega-ILECs would each commit to pursuing "out-of-region" entry in various local exchange service markets. SBC had identified thirty such markets (of which 17

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31. *Local Competition Report*, at Table 6. Connecticut had just 9% CLEC end-user switched access lines; Hawaii's CLEC share was so small that it was not even included in the FCC report, with the explanation, "data withheld to maintain confidentiality."

32. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Board's Rules*, Before the Federal Communications Commission, CC Docket No. 98-141, *Application* , Filed July 27, 1998 ("SBC/Ameritech Merger Application"), at Sec. II.A.1.

33. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the Transaction, Public Interest Showing and Related Demonstrations*, Before the Federal Communications Commission, CC Docket No. 98-184, *Application*, Declaration of Jeffrey C. Kissell, Filed October 2, 1998, ("*Bell Atlantic/GTE Merger Application*"), at para. 14.

were in what would become Verizon territory),[34] while BA/GTE (Verizon) committed to enter twenty-one markets.[35] Although various parties and their experts, including myself, were highly skeptical as to the legitimacy of these so-called "commitments," both sets of joint applicants insisted that their respective "national local strategies" would be aggressively pursued and would result in a significant enhancement of facilities-based local competition throughout the country.[36] In its Orders approving the two mergers, the FCC undertook to put some teeth into what were in other respects "soft" commitments on the part of the two sets of merger parties with respect to their out-of-region local entry plans. In its *SBC/Ameritech Order*, the Commission *required* SBC to undertake the promised out-of-region local entry, and indicated that the post-merger SBC would be fined as much as $39.6-million for *each* of the 30 out-of-region markets that it did not enter.[37] In the *BA/GTE Order*, the FCC similarly imposed the threat of fines if BA/GTE

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34. *SBC/Ameritech Merger Application*, Attachment A: "New Markets for the New SBC."

35. *Bell Atlantic/GTE Merger Application*, at para. 14.

36. *Id.*, at para. 15; *SBC/Ameritech Application*, Affidavit of James S. Kahan, at para. 27.

37. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Board's Rules*, CC Docket No. 98-141, *Memorandum Opinion and Order*, October 6, 1999, at Appendix C, para. 59(d). The FCC ordered:

> If an SBC/Ameritech Out-of-Territory Entity fails to satisfy any of the 36 separate requirements for each out-of-territory market on or before the deadlines set forth in Subparagraph c, SBC/Ameritech shall make a one-time contribution of $1.1 million for each missed requirement (up to a total contribution of $39.6 million per market and $1.188 billion if SBC/Ameritech Out-of-Territory Entities fail to satisfy all 36

(continued...)

failed to invest at least $500-million in out-of-region CLEC activities, or provide service as a CLEC to at least 250,000 customer lines, by the end of 36 months following the merger closing date.[38] As it has turned out, of course, the skepticism of various commentors and the concerns of the FCC with respect to the veracity of these out-of-region local entry "commitments" were well-founded. Verizon and SBC/Ameritech's out-of-region entry pursuant to the merger conditions has been nominal and superficial, despite their pronouncements at the time of the merger that broad out-of-region entry would be aggressively pursued.[39] The decision by both SBC and

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37. (...continued)
requirements in all 30 markets) to a fund to provide telecommunications services to under served areas, groups, or persons.

38. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the Transaction, Public Interest Showing and Related Demonstrations*, CC Docket No. 98-184, *Memorandum Opinion and Order*, Rel. June 16, 2000, at paras. 43-48.

39. Rory J. O'Connor, "Looser Reins," *eWeek*, March 26, 2001; "SBC Says It Meets Merger Terms Despite Out-Of-Region Cutbacks," *TR Daily*, March 20, 2001. In an obvious effort to escape the heavy fines that would otherwise apply, on March 5, 2002, SBC represented to the FCC that it is in compliance with its out-of-region entry commitments "for 16 of the required 30 markets," averring that "SBC Telecom, Inc. ("SBCT"), the SBC business unit with this responsibility, ... is offering local exchange service to all business customers and all residential customers throughout the areas in the market that are either (a) within the local service area of the incumbent RBOC located within the PMSA of the market or (b) within the incumbent service area of a Tier I incumbent LEC (other than SBC/Ameritech) serving at least 10 percent of the access lines in the PMSA ..." Letter dated March 5, 2002 to William F. Caton, Acting Secretary, FCC, from Carlyn D. Moir, Vice President, Federal Regulation, SBC Communications, Inc. SBC's representations to the Commission notwithstanding, the SBC Communications, Inc. website expressly indicates that service is available only in the thirteen in-region (i.e., SWBT, Pacific Bell, Ameritech and SNET) states (see fn. 74, *infra*.). Moreover, the SBC Communications, Inc. website, www.sbc.com, states that "SBC Communications, Inc. serves 20 of the largest U. S. markets," a figure that clearly does not include the out-of-region markets
(continued...)

Verizon to refrain from active pursuit of an out-of-region CLEC entry strategy suggests either that (a) both companies have concluded that such ventures will not be profitable due to the substantial economic barriers and other hurdles that they would each be required to overcome, or (b) the two companies have tacitly adopted a market allocation "agreement" in which each firm stays out of the other's territory. The first explanation clearly indicates the presence of substantial market power on the part of the incumbent LEC, while the second explanation would only be sustainable if entry by other CLECs is not a serious threat. Clearly, the two largest RBOCs, the two companies that possess more of both the resources and the technical/managerial/marketing experience and expertise that are needed to successfully pursue a CLEC-type entry than any other potential competitor, have elected (for whatever reason) not to challenge the dominant incumbent. If SBC and Verizon won't compete with each other (and with other ILECs), it is patently unreasonable, if not altogether fanciful, to expect that *any other entrant* could so limit the incumbents' market power that *as a policy matter* those incumbents could be afforded non-dominant treatment.

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39. (...continued)
purportedly being served by SBC Telecom, the SBC out-of-region CLEC business unit. Significantly, the SBC website does not even mention or provide a link to SBC Telecom; the only means by which a consumer would know about SBC's out-of-region local service offerings is by tracking down "SBC Telecom" specifically. Clearly, this "out-of-region" CLEC activity is barely on SBC's radar screen.